



Treasury Trends

Bringing currency to the Arizona Taxpayer
David A. Petersen, State Treasurer

December 2005

THE OFFICIAL NEWSLETTER FOR ARIZONA LGIP PARTICIPANTS

This month's
character trait:

Punctuality:

*Showing esteem for
others by doing the right
thing at the right time.*

*Government
Sponsored
Enterprises Continue
to Carry Triple-A
Ratings.*

LGIP Performance

The Board of Investment was informed of the performance of the Local Government Investment Pool (LGIP), LGIP-Government, and LGIP-Core-Mix for the month to date and year to date period ending December 31, 2005 during its regular meeting on January 25, 2006.

Recent Pool performance is posted on the last page including a description of each Pool and a rolling twelve month performance table for the Pools offered by the Arizona State Treasurer's Office. Contacts and other information on the Pools can also be found on this condensed one page summary sheet for your convenience.

Government Agency Review

Ken Fisher, Deputy State Treasurer of Investments

You may have read recently about some of the financial reporting difficulties facing Fannie Mae and Freddie Mac. Most of this revolves around the accounting for derivatives used in managing interest rate risk and the purchase and sale of many of the mortgages they hold. Fannie Mae and Freddie Mac keep money flowing into the housing market by buying mortgages from banks and other lenders and bundling them into securities to sell to investors. Although they are continuing the process of restating prior financial statements, as an investor, one might ask what does this mean for debt holdings issued by Fannie Mae or Freddie Mac.

There is currently a push in Washington to pass legislation that would give the Government tighter control over these Government Sponsored Enterprises (GSEs). This legislation, if passed, would give the Federal Government more authority over the size and capital structure of the GSEs. However, until the outcome of this is known, their current regulators have made both Fannie Mae and Freddie Mac post capital in excess of 30% of the amount normally required. This means, that at the end of 2005, the capital accounts for both were in excess of \$35 billion each.

In addition, the GSEs continue to receive a triple-A rating with stable outlooks by the national rating agencies. This, in part, is due to the implied guarantee by the Federal Government. However, none of the rating agencies have any GSE senior debt on credit watch for possible downgrade.

The outlook for additional oversight, additional capital and continued presence in the US housing market all point to GSE debt still being very attractive to the conservative investor. As trustees for public monies, the ASTO continuously monitors the credit markets. As of the end of January, 2005, over 85% of the debt held in the LGIP was rated top tier (A1+/A1 or AAA).

The ASTO is committed to bringing every LGIP participant the best possible service we can offer. If you would like to find out more, please contact us at your convenience.

For the First Time in Several Years, Long Term Rates are at or near the same levels as Short Term Rates..

Inverted Yield Curve

Minh Trang, Assistant Deputy State Treasurer of Investments

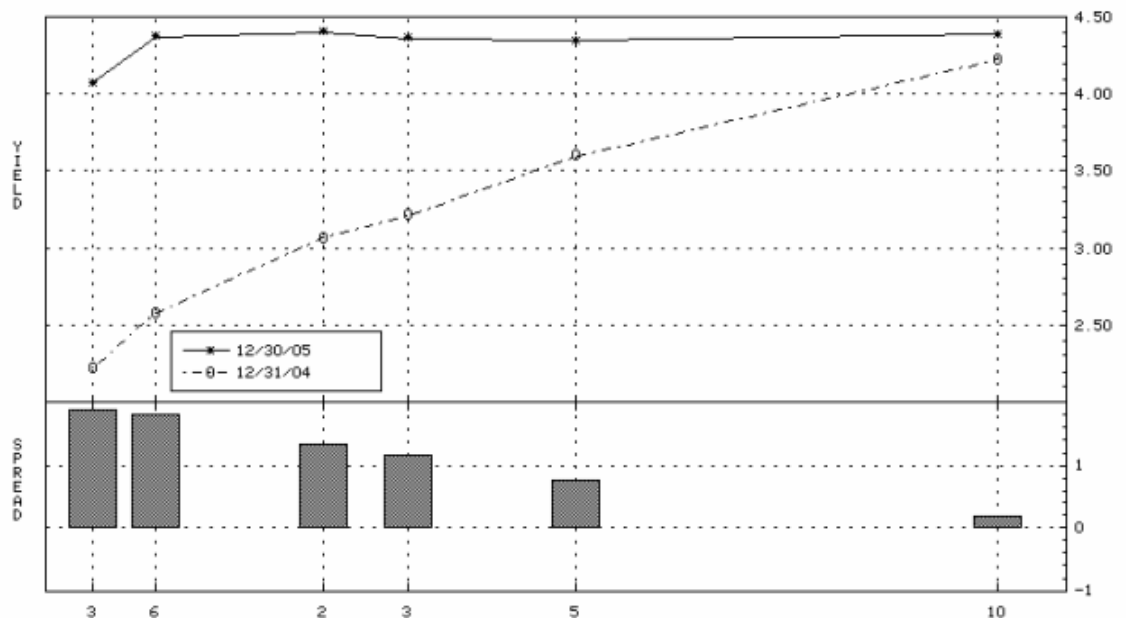
In the latest Fed meeting at the end of January, the Federal Reserve raised short term rates another .25% to 4.5%. This marked the 14th consecutive increase, with expectations of two additional rate hikes for 2006. This also marked the end of Alan Greenspan's tenure as the Federal Reserve Chairman. Ben Bernanke will succeed him.

The overall yield curve has flattened and even inverted in certain segments. This inversion poses an interesting dilemma for bond managers as the incentives for investing further out on the curve diminishes. Many believe that this anomaly simply reflects the expectations that economic growth will slow, while others anticipate this to be a temporary phenomenon. The economy continues to show great resilience throughout this monetary tightening phase, and inflation remains well contained.

Yield Curve Perspective (Source: Bloomberg LP)

Change in the 3 Month to 10 Year US Treasury Curve for One Year.

HISTORICAL YIELD CURVE



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We're on the Web!
www.aztreasury.gov

**LGIP: local & state government working together
to safeguard Arizona taxpayers' money.**

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Arizona State Treasurer's Office Local Government Investment Pools (LGIP) Fact Sheet on the Pools

OVERVIEW

LGIP (\$3.4 Billion as of 12/31/05)

Money market type fund designed to maximize your cash management program's efficiencies by providing a safe and reliable source of liquidity from the fund's portfolio of government and investment-grade domestic securities. Maximum weighted average maturity (WAM) is 240 days.

LGIP-Government (\$1.5 Billion as of 12/31/05)

Similar in style to the LGIP, but invests solely in securities that are backed by the full faith and credit of the US Government. Maximum WAM is 180 days.

LGIP-Core Mix (\$47.9 Million as of 12/31/05)

This fund invests in a longer term horizon than the LGIP cash management fund and adds the potential of total return from feasible price appreciation within the fund's portfolio of government and investment-grade domestic securities. Redemptions and Purchases are limited to the first business day of the month. Duration target is Merrill 1-5 US Domestic Master Index (not to exceed .75 years of index).

LGIP-Core-Government

Similar in style to LGIP-Core Mix, but invests solely in securities that are backed by the full faith and credit of the US Government. Duration target is Merrill 1-5 US Treasuries Index (not to exceed .75 years of index).

RECENT PERFORMANCE

	LGIP		LGIP-Gov't		LGIP-Core		LGIP-Core-Gov't	
Month	Yield	WAM	Yield	WAM	Yield	NAV	Yield	NAV
Dec '05	3.88	69	3.77	97	3.81	1.000		
Nov '05	3.73	64	3.66	113	3.62	1.000		
Oct '05	3.53	66	3.37	121	3.91	1.000		
Sep '05	3.39	75	3.27	128	4.06	0.998		
Aug '05	3.22	79	3.22	130	3.65	1.000		
Jul '05	3.04	92	3.10	119	3.37	0.999		
Jun '05	2.90	84	2.72	152	3.55	1.001		
May '05	2.77	96	2.62	121	3.37	1.003		
Apr '05	2.63	99	2.37	104	2.84	1.000		
Mar '05	2.48	93	2.29	140	2.56	1.000		
Feb '05	2.47	100	1.92	125				
Jan '05	2.30	100	1.92	142				

Yields are net of fees

Initial Funding Mar-05 Currently Unfunded

ADVANTAGES

- Professionally managed by a team of educated, experienced former public investment officers and private sector portfolio managers and traders.
- Dedicated and separate Compliance, Accounting and Portfolio Management departments ensure our dedication to meeting the LGIPs' objectives.
- Bound by the Arizona Revised Statutes and the oversight of the Arizona Legislature.
- No contracts to negotiate. Accounts are opened with an executed governing body resolution.
- Pools are managed from the viewpoint of public entities for public entities.
- Multiple accounts within the Pools are available for your accounting needs.

IMPORTANT INFORMATION

Unless otherwise stated, investors are participating in a commingled investment pool in which they are conveyed a pro rata interest in the total value of all securities in that Pool. Investors share an apportioned amount of the Pool's income and expenses based on the average daily balances of participating accounts using the accrual basis of accounting. Investment products offered by the Arizona State Treasurer's Office are not backed, insured, or guaranteed by any bank, the FDIC, the State of Arizona, or any other Federal or State Government Agency. As with any investment, past history is not a guarantee of future performance and an investment may lose value.

Please refer to the most recent "Arizona State Treasury Investment Policy for Invested Monies" for further information and important disclosures in determining if an investment in one of the LGIPs is right for your organization. Contact us at 602-604-7800 or visit us at www.aztreasury.gov on the web.